A Report to the Montana Legislature

Financial Audit

Montana Water Pollution Control and Drinking Water State Revolving Fund Programs

Department of Environmental Quality

Department of Natural Resources and Conservation

For the Fiscal Year Ended June 30, 2009

February 2010

Legislative Audit Division

10-29A

7.835045
2MWPC
09

Montana State Library
3 0864 1005 8920 2

Legislative Audit Committee

Representatives
Dee Brown, Vice Chair
Betsy Hands
Scott Mendenhall
Carolyn Pease-Lopez
Wayne Stahl
Bill Wilson

Senators
Mitch Tropila, Chair
Greg Barkus
John Brenden
Taylor Brown
Mike Cooney
Cliff Larsen

Audit Staff

Financial-Compliance
Geri Hoffman
Alexa O'Dell
Lena Tamcke

Fraud Hotline
Help eliminate fraud, waste, and abuse in state government.
Call the Fraud Hotline at:
(Statewide)
1-800-222-4446
(in Helena)
444-4446

Financial Audits

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2007, was issued January 23, 2008. The Single Audit Report for the two fiscal years ended June 30, 2009, will be issued by March 31, 2010. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
Room 277, State Capitol
P.O. Box 200802
Helena, MT 59620-0802

Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Direct comments or inquiries to:
Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705
(406) 444-3122

Reports can be found in electronic format at:
http://leg.mt.gov/audit

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

February 2010

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the fiscal year 2008-09 financial audit of the Montana Water Pollution Control State Revolving Fund (WPCSRF) and Drinking Water State Revolving Fund (DWSRF) Programs. The Department of Natural Resources and Conservation requested the audit of these programs because annual audits are required by the federal Environmental Protection Agency. These programs are administered jointly by the Department of Natural Resources and Conservation and the Department of Environmental Quality.

The objectives of a financial audit include determining if the programs' financial statements fairly present the programs' financial position at June 30, 2009, and the results of operations for the fiscal year then ended. We tested compliance with state and federal laws that have a direct and material impact on the financial statements.

The WPCSRF program provides loans at a reduced interest rate to finance construction of publicly owned water pollution control facilities, nonpoint source pollution control projects, and estuary management plans. Water pollution control loans are comprised of federal grants and state match funds and may be financed up to 30 years. As of June 30, 2009, the WPCSRF had $160,155,626 of outstanding loans, including advances to other funds.

The DWSRF program provides low interest loans to communities for the construction of drinking water treatment facilities. Drinking water loans are comprised of federal grants and state match funds and may be financed up to 30 years. At June 30, 2009, the DWSRF had $93,985,172 of outstanding loans.

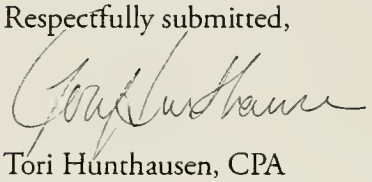
On page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion which means the reader can rely on the information presented. The programs' financial statements begin on page A-3. The programs supplementary financial information begins on page B-1. Our report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with Government Auditing Standards is on page C-1.

The response from the departments is on page D-1. We thank the directors of the Departments of

Room 160 • State Capitol Building • PO Box 201705 • Helena, MT • 59620-1705
Phone (406) 444-3122 • FAX (406) 444-9784 • E-Mail lad@mt.gov

Environmental Quality and Natural Resources and Conservation and their staff for their cooperation and assistance during the audit.

Respectfully submitted,



Tori Hunthausen, CPA
Legislative Auditor

Appointed and Administrative Officials

Department of Environmental Quality

Richard Opper, Director

Tom Livers, Deputy Director

Dean Rude, Chief Financial Officer, Financial Services

Department of Natural Resources and Conservation

Mary Sexton, Director

Ann Bauchman, Administrator, Centralized Services Division

Anna Miller, Bureau Chief, Loan and Financial Management Bureau

For additional information concerning the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs, contact:

Anna Miller, Bureau Chief
P.O. Box 201601
Helena, MT 59620-1601
(406) 444-6689
e-mail: annam@mt.gov

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Combined Balance Sheet, Special Revenue and Debt Service Funds, of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of June 30, 2009, and the related Combined Statement of Revenues, Expenditures and Changes in Fund Balances, Special Revenue and Debt Service Funds, for the fiscal year then ended. The information contained in these financial statements is the responsibility of the management of the Department of Environmental Quality and the Department of Natural Resources and Conservation. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in the notes to the financial statements, the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' financial statements are intended to present the financial position and results of operations of only that portion of the financial reporting entity of the state of Montana that is attributable to the transactions of the programs. They do not purport to, and do not, present fairly the financial position of the state of Montana as of June 30, 2009, or the changes in its financial position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

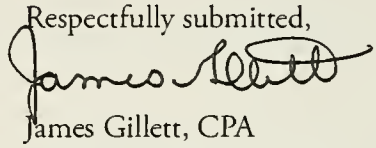
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of June 30, 2009, and results of operations for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' financial statements. The Montana Water Pollution Control and Drinking Water Schedule of

Revolving and Non-Revolving SRF Programs Balance Sheet, Special Revenue and Debt Service Funds, Regulatory Basis, as of June 30, 2009, and the related Schedule of Revolving and Non-Revolving SRF Program Revenues, Expenditures, and Changes in Fund Balances, Special Revenue and Debt Service Funds, Regulatory Basis, for the year then ended are presented for the purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the programs' financial statements and, in our opinion, is fairly stated in all material respects in relation to the programs' financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 5, 2010, on our consideration of the programs' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Respectfully submitted,



James Gillett, CPA
Deputy Legislative Auditor

February 5, 2009

MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
STATE REVOLVING FUND PROGRAMS
COMBINED BALANCE SHEET
SPECIAL REVENUE AND DEBT SERVICE FUNDS
JUNE 30, 2009

	WATER POLLUTION CONTROL			DRINKING WATER			
	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	(MEMORANDUM ONLY) TOTAL
ASSETS:							
Cash and Cash Equivalents	$17,492,856	($228)	$1,883,599	$13,866,177	$3,250	$1,730,439	$34,976,093
Interest Receivable	439,954		1,805,694	221,799		870,871	3,338,318
Accounts Receivable							0
Due from Federal Government		1,281			98,349		99,630
Due from Other Fund/Business Unit	502,100			600,000			1,102,100
Loans Receivable	142,448,655			93,985,172			236,433,827
Advances to Other Funds	17,706,972						17,706,972
Total Assets	$178,590,537	$1,053	$3,689,293	$108,673,148	$101,599	$2,601,310	$293,656,940
LIABILITIES AND FUND BALANCES:							
Liabilities:							
Accounts Payable	$915,149	$11		$125,436	$4,133		$1,044,729
Payroll Payable	20,849	472		19,829	49,853		91,003
Accrued Liability					17,285		17,285
Due to Other Business Unit or Fund	394		$10,788			$15,903	27,085
Deferred Revenue		370			528		898
Loans Payable		200			29,800		30,000
Total Liabilities	$936,392	$1,053	$10,788	$145,265	$101,599	$15,903	$1,211,000
Fund Balances							
Reserved for L/T Loans/Notes/Advances	$160,155,627			$93,985,172			$254,140,799
Reserved for Debt Service			$3,678,505			$2,585,407	6,263,912
Unreserved, Undesignated	17,498,518	$0		14,542,711	$0		32,041,229
Total Fund Balance	$177,654,145	$0	$3,678,505	$108,527,883	$0	$2,585,407	$292,445,940
Total Liabilities and Fund Balances	**$178,590,537**	**$1,053**	**$3,689,293**	**$108,673,148**	**$101,599**	**$2,601,310**	**$293,656,940**

The accompanying notes to the financial statements are an integral part of this statement.

MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
STATE REVOLVING FUND PROGRAMS
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
SPECIAL REVENUE AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

	WATER POLLUTION CONTROL			DRINKING WATER			(MEMORANDUM ONLY)
	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	TOTAL
REVENUES:							
Federal Capitalization Grant Revenue		$9,278,037			$8,176,052		$17,454,089
Interest Income on Investments	$63,566		$1,201	$30,749		$5,153	100,669
Interest Income from Loans	1,125,566		4,711,685	699,217		2,728,092	9,264,560
Other Income	73			30	270		373
Total Revenues	$1,189,205	$9,278,037	$4,712,886	$729,996	$8,176,322	$2,733,245	$26,819,691
EXPENDITURES:							
Program Administration/Set-Asides	$602,332	$133,421		$311,729	$1,473,064		$2,520,546
Total Expenditures	$602,332	$133,421	$0	$311,729	$1,473,064	$0	$2,520,546
Excess Revenues Over (Under) Expenditures	$586,873	$9,144,616	$4,712,886	$418,267	$6,703,258	$2,733,245	$24,299,145
OTHER FINANCING SOURCES:							
Bond/RAN/BAN Proceeds	$2,700,000			$3,000,000			5,700,000
Operating Transfers In:							
Debt Service Sweep	87,713			37,419			125,132
Loan Loss Reserve Sweep	1,433,969			767,852			2,201,821
Federal Capitalization Grants	9,144,616			6,703,258			15,847,874
Investment Earnings Transfers			$1,678			$164,481	166,159
Total Other Financing Sources	$13,366,298	$0	$1,678	$10,508,529	$0	$164,481	$24,040,986
OTHER FINANCING USES:							
Bond/RAN/BAN Principal			$2,945,000			$1,570,000	$4,515,000
Bond/RAN/BAN Interest			473,925			516,721	$990,646
Operating Transfers Out:							
Debt Service Sweep			87,713			37,419	$125,132
Loan Loss Reserve Sweep			1,433,969			767,852	$2,201,821
Federal Capitalization Grants		$9,144,616			$6,703,258		$15,847,874
Investment Earnings Transfers	1,678			164,481			$166,159
Total Other Financing Uses	$1,678	$9,144,616	$4,940,607	$164,481	$6,703,258	$2,891,992	$23,846,632
Excess (deficiency) of Revenues and Other Financing Sources over (under) Expenditures and Other Financing Uses	$13,951,493	$0	($226,043)	$10,762,315	$0	$5,734	$24,493,499
Fund Balances July 1, 2008	163,698,348	0	3,909,870	97,797,212	0	2,582,768	267,988,198
Prior Year Adjustments	4,304	0	(5,322)	(31,644)	0	(3,095)	(35,757)
Fund Balances June 30, 2009	**$177,654,145**	**$0**	**$3,678,505**	**$108,527,883**	**$0**	**$2,585,407**	**$292,445,940**

The accompanying notes to the financial statements are an integral part of this statement.

MONTANA STATE WATER POLLUTION CONTROL AND DRINKING WATER STATE REVOLVING FUND PROGRAMS SPECIAL REVENUE AND DEBT SERVICE FUND NOTES TO FINANCIAL STATEMENTS FOR THE FISCAL YEAR ENDED JUNE 30, 2009

1. Organization of the Programs

The State of Montana Water Pollution Control State Revolving Fund (WPCSRF) Program was established pursuant to Title VI of the Federal Water Quality Act of 1987. This federal act established the WPCSRF program to replace the construction grants program. It provides a flexible financing source to loan money at reduced interest rates to finance the construction of publicly owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the WPCSRF provides for low interest rate loans to finance the entire cost of qualified projects or to refinance debt obligations on projects. The State of Montana first incurred expenditures in the WPCSRF Program in state fiscal year (SFY) 1992.

The State of Montana Drinking Water State Revolving Fund (DWSRF) Program was established pursuant to the 1996 Amendments to the Federal Safe Drinking Water Act. This federal act established the DWSRF program for states to make loans to community water systems and non-profit non-community water systems. Instead of making grants to communities that pay for a portion of building drinking water treatment facilities, the DWSRF provides for low interest rate loans to finance the entire cost of qualified projects or to refinance debt obligations on projects that began after July 1, 1993. The State of Montana first incurred expenditures in the DWSRF Program in SFY 1997.

WPCSRF and DWSRF loan agreements allow up to 30 years for repayment. All repayments of interest and principal must remain in the revolving funds. Both programs are capitalized through U.S. Environmental Protection Agency (EPA) grants. States are required to provide 20 percent of the federal capitalization grant as matching funds for DWSRF, and 16.67 percent for WPCSRF, in order to receive a grant. The State of Montana issues General Obligation Bonds, Revenue Anticipation Notes (RANs), and Bond Anticipation Notes (BANs) to provide the required state matching funds. RANs and BANs are funded through INTERCAP Loans from the Montana Department of Commerce.

In early 2009, the U.S. Congress passed the American Recovery and Reinvestment Act (ARRA). The President signed the ARRA into law on February 17, 2009. The ARRA Capitalization Grants have several changes from past EPA Federal Capitalization Grants. The ARRA Capitalization Grant money does not require State match money on projects and administration, but does require the state to match some set-aside money in the DWSRF program. The state will use Public Water Supply program charges and fees in state special revenue funds to provide the required state matching funds. Additional program requirements were put in place for projects using these funds, such as all products used in a project must be purchased in America.

The ARRA funds must be obligated by February 17, 2010. Any funds not obligated will go back to EPA and be reallocated to states having all their ARRA funds obligated and that are in need of additional funds.

The programs are jointly administered by the Technical and Financial Assistance Bureau of the Department of Environmental Quality (DEQ) and the Conservation and Resource Development Division of the Department of Natural Resources and Conservation (DNRC). The revolving fund programs do not have any full time employees. Both funds are charged for time spent on SRF activities by department employees. The charges include salaries and benefits of the employees and operating expenses as well as indirect costs.

2. Summary of Significant Accounting Policies

A. State Revolving Fund (SRF) Program Fund Structure

Both programs use Special Revenue and Debt Service funds, as appropriate, to report the financial position and the results of operations. A Special Revenue Fund accounts for the proceeds of specific revenue sources that are restricted to expenditures for specified purposes. A Debt Service Fund accounts for resources accumulated for payment of principal and interest on general long-term obligation debt, BANs and RANs. Montana maintains State Special Revenue and Federal Special Revenue Funds. The SRF program revenues and expenses include transactions from each Special Revenue Fund. Special Revenue and Debt Service Funds are considered governmental funds.

A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions and activities.

B. Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a current financial resources measurement focus. Current financial resources means that, generally, only assets and current liabilities are included on the balance sheet. Operating statements of governmental funds present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

Governmental funds use the modified accrual basis of accounting. The modified accrual basis is the accrual basis adapted to the governmental fund-type measurement focus. Under the modified accrual basis of accounting, revenues are recorded when received in cash unless susceptible to accrual. Revenues are susceptible to accrual if they are measurable and available within sixty days after the end of the fiscal year to finance expenditures of the fiscal year. Revenues are deferred if material and received before the normal time of receipt or if received for a particular activity and the expense for that activity has not been incurred prior to fiscal year-end. Expenditures are recognized when the related fund liability is incurred, with the following exceptions:

1) principal and interest on long-term debt are recognized when due;
2) prepayments are accounted for as expenditures in the period of acquisition;
3) inventory items are considered expenditures when purchased.

The Loans Receivable account resides in the State Special Revenue fund for each program. This account represents the total principal due on the loans outstanding for each program.

C. Prior Period Adjustments

Prior period adjustments reported in the accompanying financial statements relate to corrections of errors or other correcting adjustments from prior periods not otherwise reported as sources or uses of funds.

In FY09, RANs were reclassified as Bond/RAN/BAN Proceeds to comply with the modified accrual basis of accounting.

3. Cash/Cash Equivalents

Cash and cash equivalents consist of funds deposited with the US Bank, N.A. as trustee, and include investments categorized as cash equivalents. Cash equivalents are defined as short-term, highly liquid investments with original maturities of three months or less.

Disclosures Relating to Credit Risk
Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. In accordance with the investment policy defined in the bonds trust indenture, the cash equivalent funds invested by US Bank, N.A., as trustee, are held in a Treasury Obligations Money Market Fund that invests exclusively in short-term U.S. Treasury obligations and repurchase agreements secured by U.S. Treasury obligations. The U.S. Treasury obligations in which the fund invests include U.S. Treasury bonds, notes, and bills, and are backed by the full faith and credit of the United States government.

Disclosures Relating to Custodial Credit Risk
Custodial credit risk for investments is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

The investment policy as defined in the Indenture of Trust, and contract with the trustee, does not require collateralization for cash and securities held by the trustee. Securities are registered with the Federal Reserve Bank under "U.S. Bank as trustee for the State of Montana Department of Natural Resources and Conservation." However, U.S. Bank policy is to collateralize money market funds at 101% of cost.

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The investment policy for the programs, as specified in the Indenture of Trust, does not explicitly address interest rate risk. However, the investment policy implicitly limits interest rate risk for cash equivalents by emphasizing liquidity, holding investments to maturity, and narrowly defining the eligible investments. In general, a shorter average maturity for fixed-income securities held in the money market fund means less sensitivity to interest rate changes. The average maturity in the fund as of June 30, 2009, is forty five days. The effective duration method result is NA because the program does not have any debt investments at this time.

Investment Type	Book Value	Moody's Rating	Effective Duration
Held by trustee:			
Money market funds	$34,982,291	Aaa	NA

4. Investments

Power to Invest and Investment Policy

The Board of Examiners of the State of Montana authorizes the sale and issuance of general obligation bonds, RANs, and BANs to provide the state match for the SRF programs through the issuance of an Indenture of Trust. The Board of Examiners is comprised of the Governor, Attorney General and the Secretary of State for the State of Montana. The Indenture of Trust specifies the eligible investments meeting defined rating and risk criteria in which the state may invest. The state invests funds through its trustee bank, US Bank, N.A.

Eligible investments are limited, generally, to obligations of, or guaranteed as to principal and interest by the United States of America, or by any agency or instrumentality thereof. A primary investment objective is to make investments that mature, or are subject to redemption, on or prior to the date or dates that the department anticipates that money will be required to make payments.

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The short- and long-term investments made by US Bank, N.A., as trustee, are held in U.S. Treasury bills and notes. U.S. Treasury bills have maturities of one year or less and U.S. Treasury notes have maturities greater than one year from the date of issuance.

Disclosures Relating to Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The investment policy as defined in the Indenture of Trust, and contract with the trustee, does not require collateralization for cash and securities held by the trustee. Securities are registered with the

Federal Reserve Bank under "U.S. Bank as trustee for the State of Montana Department of Natural Resources and Conservation."

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The investment policy, as specified in the Indenture of Trust, does not explicitly address interest rate risk. However, the investment policy implicitly limits interest rate risk by emphasizing liquidity, holding investments to maturity, and narrowly defining the eligible investments.

5. Loans Receivable

Montana operates both SRF programs as direct loan programs. Loans made to communities through the WPCSRF program are funded 83.33 percent by the federal EPA capitalization grant, and 16.67 percent by the state match amount. Loans made by the DWSRF program are funded approximately 80 percent by the federal EPA capitalization grant, and 20 percent by the state match amount. Some loans in both programs are made as recycled, or "second round", loans and disbursed from loan repayment funds. Loan funds are disbursed to the local borrower agencies by the trustee bank as the local borrower agencies expend funds for the purposes of the loan and request reimbursement from the program. Interest is calculated from the date that funds are disbursed. Typically after the final disbursement has been made, the payment schedule is certified in the loan agreement and adjusted for the actual amounts disbursed. No provision for uncollectible accounts has been made as all loans are current in terms of compliance with the repayment schedules, and management believes that all loans will be repaid according to the terms of the loan agreements.

The drawn and outstanding principal balance of all loans guaranteed by the WPCSRF Program as of June 30, 2009, is $160,155,627. The total loans receivable in the WPCSRF program includes $142,448,655 presented as loans receivable and $17,706,972 presented as advances to other funds. The advances are inter-fund loans within the DNRC used for the non-point source private loans program.

The drawn and outstanding principal balance of all loans guaranteed by the DWSRF Program as of June 30, 2009, is $93,985,172.

Loans mature at various intervals through July 1, 2038. The scheduled principal payments on loans and advances to other funds maturing in the years following SFY 2009 are as follows:

SFY ending June 30:	WPCSRF Amount	DWSRF Amount
2010	$ 7,233,703	$ 4,056,290
2011	10,774,900	5,732,000
2012	11,502,100	5,851,500
2013	11,972,200	6,040,500
2014 and thereafter	118,672,724	72,304,882
Total	**$ 160,155,627**	**$ 93,985,172**

As of June 30, 2009, the WPCSRF and DWSRF had authorized loans to public entities of the State of Montana that in the aggregate exceeded $257.5 and $133 million, respectively. The outstanding balances of the largest loans in each portfolio are as follows:

Water Pollution Control State Revolving Fund:

Local Agency	Authorized Loan Amount	Outstanding Balance
City of Kalispell	$ 14,470,000	$ 13,908,000
City of Great Falls	11,295,267	7,987,000
City of Helena	9,320,000	8,173,000
Big Sky/County Water & Sewer	7,000,000	5,590,000
Big Sky/County Water & Sewer	6,500,000	4,452,399
Big Sky/County Water & Sewer	5,513,000	1,697,000
City of Lewistown	5,400,000	4,507,000
City of Manhattan	4,757,000	4,581,729
Missoula WWTP	5,000,000	3,678,000
City of Billings	7,400,000	5,255,773
Total	**$ 76,655,267**	**$59,829,901**

Drinking Water State Revolving Fund:

Local Agency	Authorized Loan Amount	Outstanding Balance
City of Billings	$ 17,300,000	$ 15,121,000
City of Havre II	8,401,000	6,685,000
City of Whitefish II	5,839,000	3,487,000
City of Laurel	5,250,000	3,009,000
Big Sky WSD*	5,000,000	3,559,271
Great Falls	4,010,000	2,784,000
City of Lewistown	3,549,000	2,528,000
City of East Helena	3,234,000	2,004,000
City of Great Falls	3,000,000	2,478,000
City of Helena	2,850,000	2,606,000
Total	**$ 58,433,000**	**$ 44,261,271**

* Still drawing funds.

6. Interest Receivable

The interest receivable represents interest owed by borrowers as of June 30, 2009, for the July 1, 2009 payment. It represents the six months of interest accrued from the previous loan payment date of January 1, 2009. Interest receivable balances include $439,954 in the WPCSRF Special Administration fund and $1,805,694 in the WPCSRF Debt Service and Loan Loss Reserve funds; and $221,799 in the DWSRF Special Administration fund and $870,871 in the DWSRF Debt Service and Loan Loss Reserve funds. Interest receivable does not include interest payments received in May and June 2009 that were due July 1, 2009. Interest payments received during May and June 2009 amounted to $740,735 for the WPCSRF and $635,849 for the DWSRF.

7. Long-Term Liabilities

WPCSRF general obligation bonds and RANs payable at June 30, 2009, were as follows:

Series 1998A

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	3.5 – 5.15	$ 170,000	$ 31,045	$ 201,045
2011		180,000	22,905	202,905
2012		190,000	14,115	204,115
2013		195,000	4,778	199,778
Total Cash Requirements		**$ 735,000**	**$ 72,843**	**$ 807,843**

Series 2000B

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	4.25 – 5.60	$ 145,000	$ 124,086	$ 269,086
2011		155,000	116,623	271,623
2012		160,000	108,668	268,668
2013		170,000	100,210	270,210
2014		180,000	91,153	271,153
2015-2019		1,065,000	296,681	1,361,681
2020-2021		520,000	29,618	549,618
Total Cash Requirements		**$ 2,395,000**	**$ 867,039**	**$ 3,262,039**

Series 2001H

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	4.00 – 5.00	$ 115,000	$ 89,695	$ 204,695
2011		120,000	84,920	204,920
2012		125,000	79,820	204,820
2013		130,000	74,400	204,400
2014		140,000	68,490	208,490
2015-2019		785,000	238,365	1,023,365
2020-2022		570,000	43,638	613,638
Total Cash Requirements		**$ 1,985,000**	**$ 679,328**	**$ 2,664,328**

Series 2003D

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	2.00-3.75	170,000	23,426	193,426
2011		175,000	19,023	194,023
2012		180,000	14,050	194,050
2013		185,000	8,665	193,665
2014		190,000	2,945	192,945
Total Cash Requirements		**$ 900,000**	**$ 68,109**	**$ 968,109**

Series 2004A

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	2.00 – 4.50	$ 160,000	$ 32,148	$ 192,148
2011		165,000	27,473	192,473
2012		165,000	22,316	187,316
2013		175,000	16,573	191,573
2014		180,000	10,270	190,270
2015		185,000	3,515	188,515
Total Cash Requirements		**$ 1,030,000**	**$ 112,295**	**$ 1,142,295**

Series 2005G

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	4.00 – 4.75	$ 120,000	$ 75,290	$ 195,290
2011		120,000	70,490	190,490
2012		125,000	65,590	190,590
2013		135,000	60,390	195,390
2014		140,000	54,890	194,890
2015-2019		785,000	173,263	958,263
2020-2021		370,000	15,750	385,750
Total Cash Requirements		**$ 1,795,000**	**$ 515,663**	**$ 2,310,663**

Series 2009 RAN

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	3.25	$ 0	$ 50,200	$ 50,200
2011		2,000,000	100,400	2,100,400
Total Cash Requirements		**$ 2,000,000**	**$ 150,600**	**$ 2,150,600**

TOTAL GENERAL OBLIGATION AND RAN DEBT – WPCSRF

Payable during the year ending June 30,	Principal	Interest	Total
2010	$ 880,000	$ 425,890	$ 1,305,890
2011	2,915,000	441,834	3,356,834
2012	945,000	304,559	1,249,559
2013	990,000	265,016	1,255,016
2014	830,000	227,748	1,057,748
2015-2019	2,820,000	711,824	3,531,824
2020-2022	1,460,000	89,006	1,549,006
Total Cash Requirements	**$ 10,840,000**	**$ 2,465,877**	**$ 13,305,877**

DWSRF general obligation bonds and RANs payable at June 30, 2009, were as follows:

Series 1998F

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	3.60 – 4.85	$ 155,000	$ 84,449	$ 239,449
2011		160,000	77,675	237,675
2012		170,000	70,413	240,413
2013		175,000	62,649	237,649
2014		185,000	54,413	239,413
2015-2019		1,055,000	130,730	1,185,730
Total Cash Requirements		**$ 1,900,000**	**$ 480,329**	**$ 2,380,329**

Series 2000A

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	4.25 – 5.60	$ 130,000	$ 111,132	$ 241,132
2011		135,000	104,540	239,540
2012		145,000	97,467	242,467
2013		155,000	89,779	244,779
2014		160,000	81,627	241,627
2015-2019		955,000	265,558	1,220,558
2020-2021		465,000	26,404	491,404
Total Cash Requirements		**$ 2,145,000**	**$ 776,507**	**$ 2,921,507**

Series 2001G

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	4.00 – 5.00	$ 140,000	$ 106,765	$ 246,765
2011		145,000	100,974	245,974
2012		150,000	94,834	244,834
2013		155,000	88,351	243,351
2014		165,000	81,348	246,348
2015-2019		935,000	283,299	1,218,299
2020-2021		675,000	51,490	726,490
Total Cash Requirements		**$ 2,365,000**	**$ 807,061**	**$ 3,172,061**

Series 2003E

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	2.00 – 3.75	$ 105,000	$ 14,150	$ 119,150
2011		105,000	11,472	116,472
2012		110,000	8,460	118,460
2013		110,000	5,215	115,215
2014		115,000	1,783	116,783
Total Cash Requirements		**$ 545,000**	**$ 41,080**	**$ 586,080**

Series 2005F

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	4.00 – 4.75	$ 215,000	$ 140,600	$ 355,600
2011		225,000	131,800	356,800
2012		235,000	122,600	357,600
2013		245,000	113,000	358,000
2014		255,000	103,000	358,000
2015-2019		1,450,000	328,875	1,778,875
2020-2022		680,000	29,888	709,888
Total Cash Requirements		**$ 3,305,000**	**$ 969,763**	**$ 4,274,763**

Series 2009C RAN

Payable during the year ending June 30,	Interest Range (%)	Principal	Interest	Total
2010	3.25	$ 0	$ 124,663	$ 124,663
2011		3,000,000	150,600	3,150,600
Total Cash Requirements		**$ 3,000,000**	**$ 275,263**	**$ 3,275,263**

TOTAL GENERAL OBLIGATION AND RAN DEBT – DWSRF

Payable during the year ending June 30,	Principal	Interest	Total
2010	$ 745,000	$ 581,759	$ 1,326,759
2011	3,770,000	577,061	4,347,061
2012	810,000	393,774	1,203,774
2013	840,000	358,994	1,198,994
2014	880,000	322,171	1,202,171
2015-2019	4,395,000	1,008,462	5,403,462
2020-2022	1,820,000	107,782	1,927,782
Total Cash Requirements	**$ 13,260,000**	**$ 3,350,003**	**$ 16,610,003**

8. Fund Balance

A portion, or all, of the fund balances in the WPCSRF and DWSRF have been reserved for Loans Receivable and Debt Service, indicating that a portion, or all, of the fund balances are not available for current expenditures.

9. Program Capitalization

The WPCSRF and DWSRF programs are capitalized by grants from the EPA and matching funds from the State of Montana. All grant funds drawn are recorded as revenue. As of June 30, 2009, the EPA has awarded capitalization grants to the State of Montana of $130,158,665 for the WPCSRF program and $19,239,100 for the WPCSRF-ARRA program; $256,443,070 has been

drawn from federal and state funds for loans and administrative expenses. As of June 30, 2009, the EPA has awarded capitalization grants to the State of Montana of $102,206,788 for the DWSRF program and $19,500,000 for the DWSRF-ARRA program; $128,967,810 has been drawn from federal and state funds for loans and administrative expenses. Montana has issued general obligation bonds, RANs, and BANs totaling $28,190,000 for use as state matching funds for the WPCSRF program and $18,695,000 for use as state matching funds in the DWSRF program. Montana will also use Public Water Supply program funds, totally $1,142,354, to provide the required state match for the DWSRF-ARRA program.

10. Federal Capitalization Grant Revenues

Actual draws of federal funds differ from the amount of Federal Capitalization Grant Revenue reported on the Statement of Revenues, Expenditures and Changes in Fund Balance. This occurs because state accounting policy requires federal special revenue funds reflect a zero fund balance at fiscal year-end (with the exception of "A" accruals). Consequently, if a positive fund balance exists, deferred revenue is recorded. If a negative fund balance is reflected at fiscal year-end, an accounts receivable is established and revenue is recorded to zero the fund balance.

The following is a reconciliation of federal revenues reported on the financial statements to federal cash actually drawn during the state fiscal year:

WPCSRF

Federal Revenue - Combined Statement	**$9,278,037**
Adjustment Due From Federal Govt FY08	6,254
Adjustment Deferred Revenue FY08	(375)
Adjustment Due From Federal Govt FY09	(1,281)
Adjustment Deferred Revenue FY09	370
Other Adjustments	0
Total Federal Draws	**$9,283,005**

DWSRF

Federal Revenue - Combined Statement	**$8,176,052**
Adjustment Due From Federal Govt FY08	181,112
Adjustment Deferred Revenue FY08	(270)
Adjustment Due From Federal Govt FY09	(98,349)
Adjustment Deferred Revenue FY09	528
Other Adjustments	0
Total Federal Draws	**$8,259,073**

11. Interest Income on Investments

This revenue represents interest earnings on investments within the funds. All assets of the funds are fully invested by the trustee, to the degree possible, in investment vehicles. The investments range from U.S. Treasury obligation money market funds to long-term government securities. In

some funds, interest income is earned in one fund but transferred to another fund in accordance with terms of the bond indenture.

12. Interest Income from Loans

This revenue represents interest earnings from loan repayments made by borrowers. A typical loan carries an interest rate of 4%; however, during fiscal year 2004 the rate was decreased to 3.75% for new loans and the lower rate was continued through fiscal year 2009. The 3.75% interest rate is comprised of a loan interest rate of 2.00%, as well as a 1.00% Loan Loss Reserve fee and a 0.75% Special Administration fee. The interest income for each of these components totaled $3,261,691, $1,449,994, and $1,125,566 respectively, for the WPCSRF program; and $1,950,592, $777,500, and $699,217, respectively, for the DWSRF program. Disadvantaged communities can receive loans with an interest rate of 2.75% because no Loan Loss Reserve fee is levied.

13. Program Administration and Set-Aside Funds

This expenditure represents costs incurred by DEQ and DNRC to administer the SRF programs. This amount is limited to 4% of each grant award from the EPA. Program Administration appears under the Resource Development/Recreation function in the State of Montana Comprehensive Annual Financial Report (CAFR).

The DWSRF program includes several "sub-programs", called set-asides, which states can elect. A State may use a certain portion of its capitalization grants for the following activities:

- up to 4 percent of its capitalization grants to administer the DWSRF and provide technical assistance to public water systems;
- up to 2 percent of its grants to provide assistance to small public water systems;
- up to 10 percent of its grants for state program management activities, including administration of the state public water system supervision program, administration of the source water protection program, development and implementation of the capacity development and operator certification programs;
- up to 15 percent of its grants to assist in the development and implementation of local drinking water protection initiatives and other State programs.

In the DWSRF, the 4 percent administrative set-aside must be deposited to a separate fund, and must have separate accounting and disclosure.

DWSRF Program Administration/Set-Asides Detail:	
Administration - EPA Grants	$347,978
Administration - State Funds	311,729
Technical Assistance	91,598
State Program Management	944,216
Local Assistance	89,272
Total Administration and Set-Asides	**$1,784,793**

In the WPCSRF program, there are no set-aside funds available.

WPCSRF Program Administration Detail:	
Administration - EPA Grants	$133,421
Administration - State Funds	602,332
Total Administration	**$735,753**

14. Other Financing Sources and Uses

The Debt Service Sweep represents loan interest amounts received that exceed the debt service requirements. The balances remaining in Debt Service funds are transferred to Investment accounts in State Special Revenue funds. Both funds are required by the State Revolving Fund Program. This occurs after payments are made to the bondholders on July 15 of each year. In the Arbitrage Certificate, this activity is termed a Debt Service Sweep.

The Loan Loss Reserve Sweep represents cash in excess of the reserve requirement that is transferred from the Loan Loss Reserve funds to the Principal funds per the bond indentures. The Loan Loss Reserve funds are not required by the State Revolving Fund Program, but the state elected to have these funds to account for these transactions separately.

The Federal Capitalization Grant represents the transfer of EPA grant funds from federal special revenue funds to the Loan Accounts in state special revenue funds to fund first round loans.

The Investment Earnings Transfer represents earnings in the bond proceeds state special revenue funds transferred to the debt service fund responsible for paying long-term debt in accordance with terms of the bond indenture.

MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
SCHEDULE OF REVOLVING AND NON-REVOLVING SRF PROGRAMS
BALANCE SHEET
SPECIAL REVENUE AND DEBT SERVICE FUNDS
REGULATORY BASIS
June 30, 2009

	WATER POLLUTION CONTROL SPECIAL REVENUE		WATER POLLUTION CONTROL DEBT SERVICE FUND		DRINKING WATER SPECIAL REVENUE		DRINKING WATER DEBT SERVICE FUND		
	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	(MEMORANDUM ONLY) TOTAL
ASSETS:									
Cash and Cash Equivalents	$16,334,465	$1,156,163	$471,355	$1,412,244	$11,355,087	$2,514,340	$396,385	$1,334,054	$34,978,093
Interest Receivable		439,954	1,233,395	572,299		221,799	610,496	260,375	3,338,318
Due from Federal Government	1,281				98,349				99,630
Due from Other Fund/Business Unit	502,100				600,000				1,102,100
Loans Receivable	142,448,655				93,885,172				236,433,827
Advances to Other Funds	17,708,972								17,708,972
Total Assets	$176,993,473	$1,598,117	$1,704,750	$1,984,543	$106,038,608	$2,736,139	$1,006,881	$1,594,429	$293,656,940
LIABILITIES AND FUND BALANCES:									
Liabilities:									
Accounts Payable	$915,142	$18			$129,306	$263			$1,044,729
Payroll Payable	566	20,755			49,853	19,829			91,003
Accrued Liability					17,285				17,285
Due to Other Business Unit or Fund		394	$10,283	$525			$15,903		27,085
Deferred Revenue	370				528				898
Loans Payable	200				29,800				30,000
Total Liabilities	$916,278	$21,167	$10,263	$525	$226,772	$20,092	$15,903	$0	$1,211,000
Fund Balances									
Reserved for L/T Loans/Notes/Advances	$160,155,627				$93,985,172				$254,140,799
Reserved for Debt Service			$1,694,487	$1,984,018			$990,978	$1,594,429	6,263,912
Unreserved, Undesignated	15,921,568	$1,576,950			11,826,664	$2,716,047			32,041,229
Total Fund Balances	$176,077,195	$1,576,950	$1,694,487	$1,984,018	$105,811,836	$2,716,047	$990,978	$1,594,429	$292,445,940
Total Liabilities and Fund Balances	$176,993,473	$1,598,117	$1,704,750	$1,984,543	$106,038,608	$2,736,139	$1,006,881	$1,594,429	$293,656,940

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis, as requested by the Environmental Protection Agency (EPA) for the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs. This presentation separates certain regulated Revolving Fund (within the Fund) and Non-Revolving Fund (outside the Fund) activity by fund type. All proceeds from the EPA Capitalization Grant, corresponding state matching funds, and loan principal and interest repayments must be deposited into the Revolving Fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination Fees and Loan Loss Reserves are deposited into the Non-Revolving Fund and may be used for other water quality purposes under the federal acts mentioned above.

(1) Generally Accepted Accounting Principles (GAAP).

MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
SCHEDULE OF REVOLVING AND NON-REVOLVING SRF PROGRAM
REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
SPECIAL REVENUE AND DEBT SERVICE FUNDS
REGULATORY BASIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

	WATER POLLUTION CONTROL SPECIAL REVENUE		WATER POLLUTION CONTROL DEBT SERVICE FUND		DRINKING WATER SPECIAL REVENUE		DRINKING WATER DEBT SERVICE FUND		
	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	(MEMORANDUM ONLY) TOTAL
REVENUES:									
Federal Capitalization Grant Revenue	$9,278,037				$8,176,052				$17,454,089
Interest Income from Investments	60,155	$3,411	($4,230)	$5,431	22,602	8,147	$497	$4,656	100,669
Interest Income from Loans	(26,480)	1,152,046	3,261,691	1,449,994		699,217	1,950,592	777,500	9,264,560
Other Income	40	33			270	30			373
Total Revenues	$9,311,752	$1,155,490	$3,257,461	$1,455,425	$8,198,924	$707,394	$1,951,089	$782,156	$26,819,691
EXPENDITURES:									
Program Administration/Set-Asides	$160,110	$575,643			$1,473,064	$311,729			$2,520,546
Total Expenditures	$160,110	$575,643	$0	$0	$1,473,064	$311,729	$0	$0	$2,520,546
Excess Revenues Over/(Under) Expenditures	$9,151,642	$579,847	$3,257,461	$1,455,425	$6,725,860	$395,665	$1,951,089	$782,156	$24,299,145
OTHER FINANCING SOURCES:									
Bond/RAN/BAN Proceeds	$2,700,000				$3,000,000				$5,700,000
Operating Transfers In:									
Debt Service Sweep	87,713				37,419				125,132
Loan Loss Reserve Sweep	1,433,969				767,852				2,201,621
Investment Earnings Transfers		$1	$1,678			$1	$164,481		166,161
Total Other Financing Sources	$4,221,682	$1	$1,678	$0	$3,805,271	$1	$164,481	$0	$8,193,114
OTHER FINANCING USES:									
Bond/RAN/BAN Principal			$2,945,000				$1,570,000		$4,515,000
Bond/RAN/BAN Interest			473,925				516,721		990,646
Operating Transfers Out:									
Debt Service Sweep			87,713				37,419		$125,132
Loan Loss Reserve Sweep				$1,433,969				$767,852	2,201,821
Investment Earnings Transfers	$1,679				$164,482				166,161
Total Other Financing Uses	$1,679	$0	$3,506,638	$1,433,969	$164,482	$0	$2,124,140	$767,852	$7,998,760
Excess (deficiency) of Revenues and Other Financing Sources over (under) Expenditures and Other Financing Uses	$13,371,645	$579,848	($247,499)	$21,456	$10,366,649	$395,666	($8,570)	$14,304	$24,493,499
Fund Balances July 1, 2008	162,716,967	981,381	1,941,986	1,967,884	95,468,552	2,328,660	999,547	1,583,221	267,988,198
Prior Year Adjustments	(11,417)	15,721	0	(5,322)	(23,364)	(8,279)	(0)	(3,097)	(35,757)
Fund Balances June 30, 2009	**$176,077,195**	**$1,576,950**	**$1,694,487**	**$1,984,018**	**$105,811,837**	**$2,716,047**	**$990,977**	**$1,594,428**	**$292,445,940**

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis, as requested by the Environmental Protection Agency (EPA) for the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs. This presentation separates certain regulated Revolving Fund (within the Fund) and Non-Revolving Fund (outside the Fund) activity by fund type. All proceeds from the EPA Capitalization Grant, corresponding state matching funds, and loan principal and interest repayments must be deposited into the Revolving Fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination Fees and Loan Loss Reserves are deposited into the Non-Revolving Fund and may be used for other water quality purposes under the federal acts mentioned above.

(1) Generally Accepted Accounting Principles (GAAP).

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Basic Financial Statements Performed in Accordance With *Government Auditing Standards*

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the financial statements of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of and for the fiscal year ended June 30, 2009, and have issued our report thereon dated February 5, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the programs' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the programs' internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

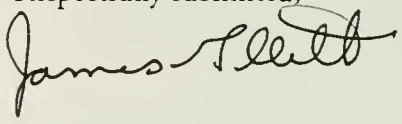
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' financial statements are free of material misstatement,

we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of the Legislative Audit Committee, the departments' management, the Montana State Legislature, and the federal Environmental Protection Agency and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Respectfully submitted,



James Gillett, CPA
Deputy Legislative Auditor

February 5, 2009

Department of Environmental Quality
Department of Natural Resources and Conservation

Department Response

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION

BRIAN SCHWEITZER, GOVERNOR

1625 ELEVENTH AVENUE

STATE OF MONTANA

DIRECTOR'S OFFICE (406) 444-2074
TELEFAX NUMBER (406) 444-2684

PO BOX 201601
HELENA, MONTANA 59620-1601

February 5, 2010

Torri Hunthausen
Legislative Auditor
Room 160, State Capitol
PO Box 201705
Helena, MT 59620-1705

Dear Mrs. Hunthausen:

We have received and reviewed the financial audit of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs for the fiscal year ended June 30, 2009. We are pleased with the unqualified opinion and wish to thank your staff for the professionalism and courtesy with which the audit was conducted.

Sincerely,

Mary Sexton
Director, DNRC

Ann Bauchman
Centralized Services Division Administrator, DNRC

Richard Opper
Director, DEQ

Dean Rude
Chief Financial Officer, DEQ

G:\Central\TS\Audit\09 SRF Audit\FY09 SRF Audit Response-letter.doc